STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MCDONNELL DOUGLAS CORPORATION	:	DETERMINATION
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Year 1984.	:	

Petitioner, McDonnell Douglas Corporation, P.O. Box 516, Airport Road and McDonnell Boulevard, St. Louis, Missouri 63166, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the year 1984 (File No. 804921).

On April 21, 1988 and April 27, 1988, respectively, petitioner and the Division of Taxation waived a hearing and agreed to submit the case for determination based upon all documentation submitted and briefs to be submitted by June 8, 1988. After due consideration of the record, Jean Corigliano, Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioner established that its failure to timely file its 1984 corporation franchise tax report with payment of tax was due to reasonable cause and not due to willful neglect.

FINDINGS OF FACT

1. On or before March 15, 1985, petitioner, McDonnell Douglas Corporation (MDC), timely filed an application for a three-month extension of time for filing its 1984 corporation franchise tax report.

2. On its application, MDC reported that it had paid tax of $251,704.00 in the preceding year and estimated that its tax liability for 1984 would be $110,000.00. In conjunction with the application, MDC paid a total estimated tax of $137,750.00 ($47,306.00 of this total was prepaid in March 1984). Subsequently, petitioner requested an additional three-month extension to September 15, 1985.

3. On or before September 15, 1985, MDC filed its 1984 corporation franchise tax report, reporting a total tax liability of $203,923.00, with a balance due of $66,173.00, plus a license fee of $443.00 for a total balance due of $66,616.00. Payment of the balance accompanied the return.

4. On December 9, 1985, the Division of Taxation ("Division") issued to MDC a Statement of Corporation Tax Adjustment, asserting an underpayment of $14,315.56. The underpayment reflected the imposition of a penalty of $15,904.99 for late filing of a report and

payment of tax. The basis for the penalty was the Division's determination that MDC's application for an extension was invalid because the tax estimated was less than 90 percent of the tax finally determined to be due.

5. On or about December 19, 1985, MDC paid the asserted liability plus interest.

6. In January 1986, MDC applied for a refund of penalties plus interest. The refund was denied by the Division on or about June 30, 1986.

7. The underpayment of estimated tax arose from the computational error of an MDC employee.

(a) MDC is a defense contractor whose business consists of assembling or manufacturing airplanes, helicopters, missiles and similar military hardware. Its sales consist primarily of a small number of very expensive items. Many of its contracts take years to complete, so that in any given year some contracts are begun, others are continued in process and other contracts completed.

(b) MDC employs two different accounting methods to report its income, the book sales method and the completed contract method. In 1984 MDC filed income tax returns in 40 states. It used the book sales method to compute its receipts allocation factor in all states except New York and Wisconsin. Under the book sales method, sales were assigned to a taxing jurisdiction either as the contract was completed or as the items were delivered.

(c) Following an earlier audit, New York instructed MDC to assign sales to New York in the year in which the contract was completed, regardless of whether deliveries of goods were made in the same year. In practice, a contract may be completed years after the goods are delivered. This accounting method was referred to by MDC as the completed contract method.

(d) In estimating MDC's tax liability for 1984, an employee inadvertently used the book sales rather than the completed contract method to determine the New York receipts factor of the business allocation percentage. This resulted in an understated percentage and an overall underestimate of tax due.

8. Because of the nature of its business, MDC's sales in any given state can fluctuate widely on a year-by-year basis. Because of this, it chose to pay an estimated tax based on its own projections, rather than exercising the option of paying 100 percent of the preceding year's tax, when filing its extension of time.

CONCLUSIONS OF LAW

A. A taxpayer, timely applying for an automatic extension of time to file its annual corporation franchise tax report, must pay on or before the date its report is required to be filed, without regard to any extension of time, its properly estimated tax (Tax Law § 213.1; 20 NYCRR 7-1.3[a]).

B. A tax is deemed to be properly estimated if the amount paid is equal to (1) not less than 90 percent of the tax finally determined or (2) not less than the tax shown on the taxpayer's report for the preceding year (Tax Law § 213.1(b)(a); 20 NYCRR 7-1.3[a]). Since MDC paid less than 90 percent of the tax finally determined to be due, the Division properly deemed its application for extension invalid; therefore, its 1984 tax report was filed late.

C. Tax Law § 1085(a)(1) authorizes the imposition of a penalty for failure to file a return required under Article 9-A on or before the prescribed date, "unless it is shown that such failure is due to reasonable cause and not due to willful neglect".

D. 20 NYCRR 9-1.5, in effect during the year in issue, provides that grounds for reasonable cause must be clearly established and may include:

> "(a) death or serious illness of the responsible officer or employee of the taxpayer, or his unavoidable absence from his usual place of business;
>
> (b) destruction of the taxpayer's place of business or business records by fire or other casualty;
>
> (c) timely prepared reports misplaced by a responsible employee and discovered after the due date;
>
> (d) inability to obtain and assemble essential information required for the preparation of a complete return despite reasonable efforts;
>
> (e) pending petition to Tax Commission or formal hearing proceeding involving a question or issue affecting the computation of tax for the year of delinquency;
>
> (f) any other cause for delinquency which appears to a person of ordinary prudence and intelligence as a reasonable cause for delay in filing a return and which clearly indicates an absence of gross negligence or willful intent to disobey the taxing statutes. Past performance should be taken into account."

E. MDC has established that there was reasonable cause for its failure to properly estimate its tax liability. In contrast to those situations in which penalties have been sustained (see, e.g., Matter of Studebaker-Worthington, Inc., State Tax Commission, June 25, 1987; Matter of Benderson Development Co., State Tax Commission, March 16, 1984), MDC has shown that it made a prudent and reasonable effort to ascertain its tax liability and to comply with all aspects of the Tax Law. The understatement of estimated tax was due to the understandable calculation error of an employee. Since the record establishes "an absence of gross negligence or willful intent to disobey the taxing statutes" (20 NYCRR 9-1.5[f]), the penalties imposed are cancelled.

F. The petition of McDonnell Douglas Corporation is granted and the Audit Division is directed to refund the sum of $15,904.99, together with such interest as may be lawfully due and owing.

DATED: Albany, New York
June 23, 1988

/s/

ADMINISTRATIVE LAW JUDGE